

Drexel eLearning, Inc.

(A wholly owned subsidiary of Drexel University)

Financial Statements for the
Years Ended June 30, 2013 and 2012, and
Independent Auditor's Report

DREXEL eLEARNING, INC.

TABLE OF CONTENTS

	Page
INDEPENDENT AUDITOR'S REPORT	1
FINANCIAL STATEMENTS:	
Balance Sheets as of June 30, 2013 and 2012	2
Statements of Income and Retained Earnings for the Years Ended June 30, 2013 and 2012	3
Statements of Cash Flows for the Years Ended June 30, 2013 and 2012	4
Notes to Financial Statements as of and for the Years Ended June 30, 2013 and 2012	5 – 8



Independent Auditor's Report

To the Board of Directors and
Stockholder of Drexel e-Learning, Inc.

We have audited the accompanying financial statements of Drexel e-Learning, Inc., which comprise the balance sheet as of June 30, 2013, and the related statements of income and retained earnings, and of cash flows for the year then ended.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on the financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Company's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Drexel e-Learning, Inc. at June 30, 2013, and the results of their operations and their cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matter

The financial statements of the Company as of June 30, 2012 and for the year then ended were audited by other auditors whose report, dated November 9, 2012, expressed an unmodified opinion on those statements.

PricewaterhouseCoopers LLP

November 20, 2013

DREXEL eLEARNING, INC.

BALANCE SHEETS

AS OF JUNE 30, 2013 and 2012

	<u>2013</u>	<u>2012</u>
ASSETS		
CURRENT ASSETS:		
Cash	\$ 5,105,477	\$ 4,637,017
Prepaid expenses and other assets	763,140	974,567
Receivable from Drexel University – net	<u>5,530,560</u>	<u>5,425,077</u>
Total current assets	11,399,177	11,036,661
PROPERTY, PLANT and EQUIPMENT – Net	<u>926,261</u>	<u>995,322</u>
TOTAL	<u>\$12,325,438</u>	<u>\$12,031,983</u>
LIABILITIES AND STOCKHOLDER'S EQUITY		
LIABILITIES:		
Accounts payable	\$ 326,901	\$ 294,008
Accrued expenses	<u>1,739,931</u>	<u>1,991,212</u>
Total current liabilities	2,066,832	2,285,220
Deferred tax liability	<u>98,850</u>	<u>-</u>
Total liabilities	<u>2,165,682</u>	<u>2,285,220</u>
STOCKHOLDER'S EQUITY:		
Common stock, par value \$0.01 per share – authorized 100 voting shares; issued 100 shares; authorized 100 Non-voting shares; issued 0 shares	1	1
Additional paid-in capital	4,228,602	4,228,602
Retained earnings	<u>5,931,153</u>	<u>5,518,160</u>
Total Stockholder's equity	<u>10,159,756</u>	<u>9,746,763</u>
TOTAL	<u>\$12,325,438</u>	<u>\$12,031,983</u>

See accompanying notes to financial statements.

DREXEL eLEARNING, INC.

STATEMENTS OF INCOME and RETAINED EARNINGS FOR THE YEARS ENDED JUNE 30, 2013 and 2012

	<u>2013</u>	<u>2012</u>
REVENUE – Fees	<u>\$22,122,240</u>	<u>\$21,700,576</u>
Total revenues	<u>22,122,240</u>	<u>21,700,576</u>
EXPENSES:		
Payroll, payroll taxes, and employee benefits	8,506,467	7,969,329
Marketing	7,057,527	8,746,250
Non-capital equipment and software	1,831,905	1,206,008
Depreciation	407,556	365,210
Professional fees	1,628,072	922,747
Office expenses	413,675	361,114
Rent	397,418	351,905
Taxes - other than income	31,311	30,716
Travel and entertainment	501,755	516,943
Miscellaneous	<u>305,677</u>	<u>278,787</u>
Total expenses	<u>21,081,363</u>	<u>20,749,009</u>
OPERATING INCOME	1,040,877	951,567
INTEREST INCOME	<u>5,811</u>	<u>6,905</u>
INCOME BEFORE INCOME TAXES	1,046,688	958,472
INCOME TAXES	<u>(633,695)</u>	<u>(577,468)</u>
NET INCOME	412,993	381,004
RETAINED EARNINGS – Beginning of year	<u>5,518,160</u>	<u>5,137,156</u>
RETAINED EARNINGS – End of year	<u>\$ 5,931,153</u>	<u>\$ 5,518,160</u>

See accompanying notes to financial statements.

DREXEL eLEARNING, INC.

STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED JUNE 30, 2013 and 2012

	<u>2013</u>	<u>2012</u>
OPERATING ACTIVITIES:		
Net income	\$ 412,993	\$ 381,004
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	407,556	365,210
Changes in assets and liabilities:		
Prepaid expenses and other assets	211,427	(460,675)
Receivable from Drexel University – net	(105,483)	(1,842,667)
Accounts payable and accrued expenses	<u>(119,538)</u>	<u>17,114</u>
Net cash provided / (used) by operating activities	<u>806,955</u>	<u>(1,540,014)</u>
INVESTING ACTIVITIES – Purchases of property, plant & equipment	<u>(338,495)</u>	<u>(352,760)</u>
Net cash used in investing activities	<u>(338,495)</u>	<u>(352,760)</u>
NET INCREASE (DECREASE) IN CASH	468,460	(1,892,774)
CASH:		
Beginning of year	<u>4,637,017</u>	<u>6,529,791</u>
End of year	<u>\$ 5,105,477</u>	<u>\$ 4,637,017</u>
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid for income taxes	<u>\$ 576,611</u>	<u>\$ 495,000</u>

See accompanying notes to financial statements.

DREXEL eLEARNING, INC.

NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2013 and 2012

1. ORGANIZATION

Drexel eLearning, Inc. (the "Company") is a wholly owned, for-profit subsidiary of Drexel University ("Drexel") that specializes in marketing and supporting innovative internet-based distance education programs for working professionals and corporations in the U.S. and abroad.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation – The accompanying financial statements have been prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America ("GAAP").

Cash – Consists of bank deposits available for operations with original maturities of 90 days or less.

Use of Estimates – The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

Revenue Recognition – The Company earns fee revenue for the recruitment and support of students for Drexel online courses. This revenue is derived from a fixed fee arrangement with Drexel which is supported by a Master Agreement executed between the two parties effective July 1, 2012. The Master Agreement calls for the annual fixed fee amount to be agreed upon in advance of the start of the fiscal year and is payable in four equal quarterly invoices.

Receivable from Drexel University – Net – Represents the fees owed to the Company from Drexel in accordance with the revenue recognition policy stated above.

Property, Plant and Equipment – Property, plant and equipment are recorded at cost less accumulated depreciation. The Company capitalizes items that are individually \$2,500 or greater in cost. Expenditures under that threshold or for normal repairs and maintenance are expensed as incurred. Depreciation is computed using the straight-line method over the estimated useful lives of the assets. Software is depreciated based on a three year useful life. Equipment is depreciated over useful lives ranging from three to five years, and furniture and fixtures generally have useful lives of five years. Leasehold improvements are depreciated over the shorter of their lease term, or their useful life.

Advertising – The Company expenses advertising as it is incurred using various forms of media, including print, online search, email campaigns, radio and outdoor formats. Advertising costs for the years ended June 30, 2013 and 2012 were \$6,353,971 and \$8,077,402, respectively.

Income Taxes – The Company accounts for income taxes in accordance with Accounting Standards Codification (“ASC”) 740-10, *Accounting for Income Taxes*. Accordingly, the Company uses the liability method whereby deferred tax assets and liabilities are determined based on temporary differences between the bases used for financial reporting and income tax reporting purposes. The Company has deferred tax liabilities that are provided based on the enacted tax rates expected to be in effect at the time such temporary differences are expected to reverse. The Company’s Federal, State and City Income Tax Returns for 2010 through 2013 remain subject to examination by the Internal Revenue Service and its state and local counterparts. GAAP requires that a tax position be recognized or derecognized based on a “more likely than not” threshold. This applies to positions taken or expected to be taken in a tax return. The Company does not believe its financial statements include any uncertain tax positions.

Recent Accounting Pronouncements – The Company has determined that there are no recently issued accounting standards that will have a material impact on its financial statements.

Reclassifications – Certain accounts in our June 30, 2012 financial statements were reclassified to conform to the June 30, 2013 presentation. Such reclassification was considered immaterial to the presentation of the financial statements.

3. PROPERTY, PLANT and EQUIPMENT

Property, plant and equipment as of June 30, 2013 and 2012, consisted of the following:

	<u>2013</u>	<u>2012</u>
Software	\$ 718,918	\$ 430,621
Equipment	546,249	492,551
Furniture and fixtures	293,837	293,837
Leasehold improvements	<u>810,510</u>	<u>814,010</u>
Total property, plant and equipment – gross	2,369,514	2,031,019
Less: accumulated depreciation	<u>(1,443,253)</u>	<u>(1,035,697)</u>
Total property, plant and equipment – net	<u>\$ 926,261</u>	<u>\$ 995,322</u>

Depreciation and amortization expense associated with property, plant and equipment totaled \$407,556 and \$365,210 for the years ended June 30, 2013 and 2012, respectively.

4. RELATED PARTY TRANSACTIONS

As noted above, the Company is a wholly owned, for-profit subsidiary of Drexel University (Parent) which provides marketing and support services for an agreed upon fixed-fee each fiscal year. These fees amounted to \$22,122,240 and \$21,700,308 for the years ended June 30, 2013 and 2012, respectively, and are paid quarterly. Certain nominal operating expenses are cross-charged between Parent and the Company and are settled quarterly on a net basis. As of June 30, 2013 and 2012, a net receivable due from the Parent amounted to \$5,530,560 and \$5,425,077.

On June 13, 2005, the Company signed a five-year lease agreement with Academic Properties, Inc. (a wholly owned subsidiary of Drexel) to rent space in One Drexel Plaza. This lease has been amended four times, most recently as of December 2011 and covers six specific spaces within the property. Monthly base rent under the amended lease agreement was \$13,510 and \$13,155 for the years ended June 30, 2013 and 2012, respectively. The lease expires on June 30, 2016.

5. 401(k) PLAN

The Company established the Drexel eLearning 401(k) Plan for the benefit of its employees. Upon completion of one month of service, the Plan provides eligible employees with an opportunity to make tax deferred contributions into a long-term investment and savings program. All employees over the age of 21 are eligible to participate and contribute up to 25% of pre-tax earnings, subject to Internal Revenue Service limitations. The Company matches up to the first 6% of such employee contributions. The Company's contributions amounted to \$328,842 and \$272,761 for the years ended June 30, 2013 and 2012, respectively.

6. PROFIT SHARING PLAN

The Company has established a profit sharing plan that allocates a portion of a pre-approved profit sharing pool to each of its employees. The profit sharing pool for the years ended June 30, 2013 and 2012 was calculated as 4% of revenue plus 25% of Earnings before Interest and Taxes ("EBIT"). Under the terms of this plan, the profit sharing pool will not exceed 25% of the Company's aggregate base compensation in the applicable fiscal year, and no amount paid to an individual employee may exceed 100% of that individual's base pay. The expense provided under the profit sharing plan during the plan years ended June 30, 2013 and 2012 was \$1,145,109 and \$1,105,887, respectively.

7. INCOME TAXES

The components of income tax expense for the years ended June 30, 2013 and 2012 are summarized as follows:

Current:		<u>2013</u>	<u>2012</u>
Federal		\$ 340,072	\$ 364,654
State		132,684	145,897
Local		<u>62,089</u>	<u>66,917</u>
		<u>534,845</u>	<u>577,468</u>
Deferred:			
Federal		<u>98,850</u>	<u>-</u>
Total		<u>\$ 633,695</u>	<u>\$ 577,468</u>

During 2013, management identified an error in the accounting for deferred income taxes and recorded an adjustment of \$87,533, of which \$57,641 and \$29,892 related to 2012 and years prior to 2012, respectively, to provide for a deferred tax liability and related expense on the cumulative temporary difference between book and tax depreciation expense. The correction of the error was recorded in 2013 as it was not considered material to either the current or previous issued financial statements.

A reconciliation of income tax computed at the U.S. statutory rate to the effective income tax rate is as follows:

	<u>2013</u>	<u>2012</u>
Statutory U.S. Federal income tax rate	35.0%	35.0%
State income taxes, net of Federal benefit	8.2	9.9
Local income taxes, net of Federal benefits	3.8	4.5
Non-deductible expenses	4.0	9.8
Provision for deferred taxes	9.4	-
Other	<u>0.1</u>	<u>1.0</u>
Effective income tax rate	<u>60.5%</u>	<u>60.2%</u>

8. LEASES

Future minimum lease payments under operating leases that have initial or remaining non-cancelable lease terms in excess of one year at June 30, 2013 are:

Fiscal Years	Amount
2014	\$ 179,207
2015	171,978
2016	177,137
2017	-
2018	<u>-</u>
Total minimum payments	<u>\$ 528,322</u>

9. SUBSEQUENT EVENTS

The Company has evaluated subsequent events from June 30, 2013 through November 20, 2013, and determined that there were no additional subsequent events requiring adjustment or disclosure in the financial statements.